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Editorial Comment

New Price and Wage Levels

Wartime controls are now being abandoned, while purchasing power is still in excess of the supply of goods, so that the immediate effect is a general advance in prices and wages. Of course it was generally expected that the postwar levels would be up. For one thing, wages and other costs did increase during the war period, in spite of all the controls. Further, governmental debts have greatly increased, so that some depreciation in the value of money became almost a requisite of public policy. Unfortunately, this is the kind of thing which, once started, is hard to stop. When paper money was exchangeable for gold there was a rigid control, and if for any reason the gold content of the currency was changed, it merely meant a general adjustment to the new level. But now there is no gold redemption and little prospect of it, nor in fact is there any direct relation between the gold stock and the volume of paper money within a given country. The door is wide open, and under these conditions the inclination of governments is to spend and borrow. Unless this trend can be stopped and prices and wages stabilized, whether by individual governments or by international control, we are doomed to an era of strikes, scarcities and unsettlement,

heading more and more rapidly towards complete loss of currency value. If prices can not be stabilized at 25 per cent, or 50 per cent, or some other reasonable mark-up over pre-war, there is no reason to expect that they can any more easily be fixed at 100 per cent or at 200 per cent. Our governments have persistently lectured us on the evils of inflation. Now the war is over, and they no longer are under pressure to spend for national survival. The problem of stability and security is in their own hands.

Further Trade Considerations Following the address of Finance Minister Ilsley at the Ontario Institute dinner, which was printed in our April issue, we have in this May issue an address by M. W. Mackenzie, C.A., Deputy Minister of Trade and Commerce, at the annual dinner of the Quebec Society. Mr. Ilsley dealt in a broad way with the commercial position of the leading nations, and concluded with the view that freedom of exchange was not yet in sight. Mr. Mackenzie's address refers more specifically to the problems of trade, and further points to a large measure of governmental direction. Whatever the merits of the arguments presented, they leave us far from the ideals of trade and exchange which were voiced in the Atlantic charter and at other times during the war period. At a time when Canada, in common with other countries, is desperately in need of trade expansion, the mechanism of international affairs seems hopelessly short of the freedom of commerce and exchange which is essential to general prosperity.

The Problem of Security The desire for security is a natural sentiment, and in fact is much the same thing as the characteristics of work and thrift which have always been lauded as virtues. The only real difference of opinion, in respect to security itself, is as to the way in which we can come nearest to attaining it. Under private enterprise, as so well exemplified during the nineteenth century, a comparatively few had bountiful security, the bulk of the people had a reasonable degree in the form of shops, farms, jobs and small savings, while a considerable minority were in want. The strongest argument in favor of this system was its proven record, at least in the countries of Europe and America, of a steady

rise in the welfare of the average person. Against this there has been an undoubted trend towards industrial centralization which, even though the lot of the worker has greatly improved, nevertheless deprived him of the simpler independence of the shop or the farm. And two costly wars, for which private enterprise itself can hardly be blamed, have been almost too much for any system to endure.

People therefore have looked elsewhere, as they have so often in the past. At times some found it in religious organizations, but these never aspired to total production. Perhaps the closest approach was the feudal system, where each person worked and fought as a member of a close knit local group. Now that nationalism is in the saddle, the natural recourse is to the state as the provider. But a country is much greater and more complex than is a local community and no machinery is yet in sight whereby all of its activities can be centrally directed. The immediate program therefore aspires merely to charge the national production with the support of those who fail to provide for themselves and hopes that this may be done without damage to the overall result.

Tax Reform From the drift of the evidence to date, and
Foreshadowed from discussion within the sessions, it ap-
 pears that the Senate tax committee will
 make at least two recommendations—one
for a simplification of the income tax act itself and another
for the establishment of a board of review. The need for
the first is obvious to anyone who attempts to read the
statute, and is recognized by the department itself, while
the second is felt by many people to be a desirable part of
the assessment procedure. These are definitely adminis-
trative questions, and therefore well within the committee's
scope. Actually the statute and the department provide the
machinery for collection, and considerable variation in the
tax rates should be possible through simple amendments to
the statute. It is only when taxation is radically changed,
in volume or in character, that policy and administration
present a common problem. The tax needs of the war
extended our income tax from the comparatively well off
to the masses, multiplied the number of taxpayers, brought

wage and salary deductions, and introduced a large number of refinements designed to meet special circumstances. With rate reductions already made and still to come, the difficulties are modified, but there is no prospect that the tax will be pushed back to its pre-war level. Whatever other devices may be used in public finance, we will have a substantial income tax for years to come, but it is an opportune time for working out the best kind of an act, administration and forms, and at least trying for reasonable stability in rates.

*Income Tax
Handbook*

The 1946 edition of the Income Tax Handbook was published by our Association in April, and copies have been distributed to all members in Canada. Owing to the substantial increase in the size of the book, to 303 pages, and to the rise in publication costs, it has been necessary to increase the price of the book from \$1 per copy previously announced to \$1.50 per copy postpaid.

International Trade Development and the Accounting Profession

By M. W. Mackenzie, C.A.

Deputy Minister of Trade and Commerce, Ottawa

An address before the Society of Chartered Accountants of
the Province of Quebec, March 28, 1946

I WOULD like, first, to say a word about the Department of Trade and Commerce. Its activities concern a number of fields and it provides a good many services which are now taken for granted, but all of which are in themselves important. It is probably not generally known that the Department of Trade and Commerce is responsible for seeing that your wife gets full weight when she buys a pound of sausages at the grocery store, or that you get full measure when you fill your automobile tank at the gasoline pump. The department also looks after your interests when you buy an article of silverware which is marked "sterling". The gas meter in your house is periodically checked by officials of the Department to see that you are getting full value. Then the department is in the show business and is responsible for Canada's participation in international fairs, such as the New York World's Fair. Closely associated with this is the tourist business and the activities of the Canadian government travel bureau, which have recently been transferred to the department. Then there is the Board of Grain Commissioners which, through its operations of licensing and control of elevators, makes possible the financing of the grain crop. An important part of the department is the Dominion Bureau of Statistics, whose operations are familiar to a good many of you. The activities of the department, however, which probably come first to mind are those connected with the development of international trade. In this field the department is responsible for the payment of subsidies necessary for the operation of coastal and international steamship routes; the provision of export credits insurance, through our newly-formed Insurance Corporation; and the assistance, through the Canadian Export Board, to foreign governments and UNRRA in procuring goods in Canada.

Then last, but not least, we have the newly-reorganized Foreign Trade Service, directly concerned with the promo-

tional activities in international trade. This service includes our trade commissioners stationed throughout the world, as well as the various activities carried on in Ottawa concerned with commercial relations, foreign tariffs and trade treaties; the stimulation of imports; the issuance of export permits; and the encouragement of exports through close association with export industries and general publicity on matters affecting foreign trade.

The responsibility for all these activities and more — notably the Canadian Shipping Board and the Wheat Board — rests with the minister, and you can readily understand that he has a very full-time job; because in addition to his own departmental responsibilities, he has many obligations flowing from Cabinet committees and various aspects of general governmental policy. In addition to this, he finds time to undertake very necessary and useful trade promotional trips, such as his recent tour of Central America. All in all, the Department of Trade and Commerce is a pretty busy place these days. But I did not come down here to bore you with the details of our organization; rather, it was to say something about the background against which we are building that organization—a background which, to my mind, makes it so necessary that business and government work together in the field of international trade development.

Trade Important to Canada

There can be little doubt of Canada's dependence on international trade. There never has been a period of prosperity in Canada which was not associated with a period of high volume of international trade, and the reasons for this are not hard to find. One has only to look at the nature of our resources and their natural markets, compared with our import requirements and their sources. Canada's resources are highly specialized, with the result that we have large export surpluses in many commodities—wheat and grain, forest products, base metals, fish, meat and cheese, to mention but some of them; and large import requirements in such things as petroleum, coal, citrus fruits, steel products and textiles. If we cannot sell the first group, we cannot buy the second, with disastrous effects on our domestic employment and our standard of living. Furthermore, because of geography and other valid economic rea-

sons we cannot sell a good deal of what we have available to export to the particular people from whom we purchase our imports. It is, therefore, of the utmost importance for our welfare that international trade be conducted on triangular or multilateral lines, which will enable us to sell to certain countries and use the proceeds of those sales to buy from other countries.

The system of trading that we used to know, which depended on the convertibility of one type of foreign currency into another, broke down to some extent during the first world war, but this time it has broken down much more seriously. However much we would like it one can hardly look for a restoration of the conditions that prevailed prior to the first great war, because of two fundamental factors. The first was that of an enduring peace—because for about 100 years there was no major international conflict; and the second was that there was a common ideology between the major trading nations. The threat of war or fear of outbreak of war probably does more to disrupt international trade than any other factor, and only to the extent that that fear can be removed can there be a development of international trade. Coupled with that is the conflict of philosophy as to how international trade should be carried on. We have at one extreme those nations who favour complete state trading; then there are those who lean toward a large measure of state control in international trade; and at the other extreme are those who strongly adhere to the competitive system. To permit the development of trade under these conditions all efforts are being bent towards designing a framework within which international disputes can be settled and under which rules and procedures for the conduct of international trade can be determined. One cannot discuss all the matters that have a bearing on these questions, because they are so many and varied, but it is an important fact that each of the proposals now under discussion has a bearing on the other — the United Nations Organization, with its Security Council and Economic and Social Council; the Food and Agriculture Organization; the International Monetary Fund and Bank; and the proposed International Trade Organization. You have probably all seen, and I hope some of you have given study to, the proposals of the United States government for the expansion of world trade and employment. These are

the proposals which will be given preliminary study some time this year by the principal trading nations of the world. They are of the utmost importance to Canada; but, important as are tariffs, preferences, cartel policy and commodity agreements, the proposals for dealing with these matters would have little effect unless they were coupled with agreements for the convertibility of foreign exchange and the adoption of the principle of non-discrimination through exchange techniques—that is, the matters covered in the Bretton Woods agreements. First-class economic warfare can be waged through the manipulation of currency control, as witness the activities of the famous Dr. Schacht.

Loans and Credits

Canada has made significant contributions to all these proposals—contributions which are quite in keeping with our position as one of the major trading nations of the world. Furthermore, recognizing that these proposals are in the nature of longer-term objectives, there has been a very real contribution made by this country to bridging the transitional period. In this group I mention our contributions to UNRRA and our direct foreign loans. These interim measures are designed primarily to assist in the restoration of the physical damage of war as well as to enable the war-torn countries to take their part in the proposed international organizations. The Canadian government is proposing to advance credits of about one billion dollars a year during 1946 and 1947 to enable other countries to buy the goods necessary for their rehabilitation; and, as I have said, to enable those countries to take their place in the proposed world organizations. Two billions of dollars is a lot of money, but spread over two or possibly more years, and considered in relation to the extraordinary measures we undertook during wartime, and the end purposes of the loans, it does not seem out of proportion. To get it in its true perspective it must be related to the cost of war, because in essence these loans are essentially an investment in future prosperity and world peace. One cannot evaluate the true cost of war in dollars and cents, nor is a comparison easy between loans which have good prospects of repayment and the absolute waste of war expenditure. But there is, nonetheless, a relation that must be borne in mind. It must be remembered, too, that for a number of

years the output of this country has been very largely given away in the common cause. It would be unrealistic to contemplate a sudden and immediate cessation of assistance to enable other countries to buy our goods—both from our own point of view in contemplating the transition from a war to a peacetime economy, and from our customers' point of view in contemplating their rehabilitation.

Protective Tariffs

In all these efforts to build international trade there is one point that is of great significance to those engaged in general business activities in this country—it is the declared intention of the United States and the United Kingdom to lower tariffs and reduce trade barriers. This agreement between the United States and the United Kingdom is strengthened by the acceptance by some fifteen of the major trading nations of the world of an invitation to discuss the United States proposals at a conference to be held some time this year. I think these facts give a good indication of the way in which the wind is blowing, and it seems pertinent to ask the question "What does this mean to our manufacturers and merchandisers, and what does it mean to the profession of accounting?" To manufacturers and merchandisers I think one could point to Mr. Ilsley's statement announcing the setting up of the recently-formed Trade and Tariff Committee. This committee was set up to hear representations from Canadian industry as part of the preparation for the trade discussions of this year. Mr. Ilsley in announcing the Committee said: "It is desirable that representations by Canadian industries and groups should take account of the American proposals for the expansion of world trade and, therefore, should not have as their objective the raising of tariff rates; and, further, that particular attention should be given to the possibilities of enlarging the access of Canadian industry to external markets". The committee, which is operating under the chairmanship of the chairman of the Tariff Board, is endeavouring to get information which will determine the particular reductions in the tariffs of other countries that would be of the greatest benefit to Canada, and, at the same time, to get information that will determine the effect on the Canadian economy of any reductions in the Canadian tariff that may be given in exchange. The whole emphasis

is on a reduction of tariffs, but I want to repeat that this emphasis is not simply a matter of Canadian government policy. It is the trend of thinking in the trading nations of the world that are now endeavouring to put into practice the spirit of the Atlantic Charter, and avoid a repetition of the self-sufficiency policies that were followed after the last war, with such disastrous results. It seems to me that, under the general adoption of more liberal trading policies by all leading commercial countries, Canadian industry must be prepared and could well afford to meet greater, rather than less, foreign competition in serving the domestic market. Tariff reductions that permit of increased competition in the domestic market, if given in exchange for concessions that provide easier access to foreign markets, need not concern unduly many of our industries, even though such industries heretofore have devoted themselves largely to serving the Canadian market. I believe it can be demonstrated that during the war, when practically all industries were producing in substantial volume, we were able to produce many types of manufactured goods in this country at costs competitive with the other principal supplying countries. This general statement may not be true in all fields, but there are a number of important industries which were either developed or expanded during the war which have shown that, with volume, they can compete in world markets. This is one of the important reasons why Canadian industry should now be considering the possibility of entering into the export field as a means of ensuring volume production in Canada in the years that lie immediately ahead. It would be extremely unwise to suggest that this situation requires every manufacturer in Canada to enter the export field. There are many whose particular circumstances do not qualify them for this type of business; but what is needed is serious consideration by manufacturers of the possibilities in the export field, of what is involved in entering that field, and the qualifications that are necessary to make a success of it—having regard particularly to the time when the present sellers' market has changed to a buyers' market; or, in other words, when we emerge from a condition of world-wide short supply.

This, it seems to me, should suggest to the accounting profession the great importance of careful study of cost

accounting and the relation of volume to costs. Recognizing that at least in the early stages of development, and probably more often than not on a continuing basis, the overhead of a concern must be carried on its domestic business, there is a question worthy of investigation as to the extent to which additional volume produced by export markets needs to be charged with a share of all overhead expenses. That is but one of the specific subjects for enquiry that flows from a study of the current trends..

National Accounting

Then there is another field, somewhat different but not altogether unrelated, to which I think the accounting profession might well devote some attention. It is a field that might be described as national accounting, by which I mean the determination of national income—not the preparation of the Dominion's balance sheet. This is a field that is usually considered the special sphere of the economist and statistician, but I do not see why it should be theirs exclusively. Of recent years there has been a tremendous increase in the importance attached to figures of national income and to statements of a country's international position, both on current and capital account. These figures are important because of their relation to budget policy, employment policy, commercial policy and so on. Until a few years ago the business of keeping track of the nation's income and of foreign assets and indebtedness was a rather casual and academic type of statistical study, but I think it is now becoming a job to which the accountant should be able to make a real contribution. Why should not a profession, which above all else is concerned with the determination of income in the general sense, not play an important part in the determination of national income?

And may I point out, too, that these calculations are used for specific purposes in addition to their use as background information in policy making. The allocation of costs among the contributing countries to UNRRA is based on calculations of national income. Then there is the clause in the recently-negotiated Anglo-American loan agreement providing for a waiver of interest, which is tied to an appraisal by the International Monetary Fund of Britain's reserves and her ability to pay.

I am sure that in all these matters the accounting profession can make a contribution, and I am reminded of that very useful book, "Financial Accounting", in which the distinguished author, George O. May, makes a statement to the effect that a lot of erroneous conclusions would have been avoided if statisticians and economists had learned the principles of double entry, rather than relying on their single entry compilations.

It is because of the importance of all these matters to Canada and, therefore, to you, that I urge a consideration of the wider horizons open to the profession. We in the Department of Trade and Commerce are doing what we can to stimulate interest and discussion of international trade problems, and it is against this general background, that I have tried to sketch, that we are shaping our organization, towards the end of fulfilling our part in the all-important job of trade development—a job in which we have an important role, but which in the last analysis can only be done by industry itself.

THE AUDITOR'S REPORT

By A. Ian Fleming. C.A.

The Balance Sheet and P. and L. reflect financial worth,
Though truth to tell they sometimes only show financial dearth;
Investors scan the figures making sure they won't be caught,
But no one gives a hoot about the Auditor's Report.

Some look at annual earnings, others look at net book worth;
Some strike out goodwill items saying "We must come down to earth";
Some even add the figures seeing if either side is short;
But no one gives a hoot about the Auditor's Report.

With statisticians' manuals investigators grope;
With earnings records, prices' range and dividends they cope
To help investors find out "should the shares be sold or bought";
But no one gives a hoot about the Auditor's Report.

And when the annual Balance Sheet appears in the press,
And when the chairman of the board delivers his address,
You'd be surprised how keenly are the facts and figures sought;
But no one gives a hoot about the Auditor's Report.

And when the structure crumbles with the passing of the years,
Investors tear their hair and start to shed their sorry tears
To see their fine security is worth exactly naught;
But no one gave a hoot about the Auditor's Report.

Accrual Basis of Assessment

Complete text of judgment of The Exchequer Court of Canada, January 10, 1946, in Thomas D. Trapp, Appellant, and Minister of National Revenue, Respondent.

THORSON, J.:—This appeal raises two important related questions; one, whether a taxpayer is entitled, as a matter of right, under the *Income War Tax Act*, R.S.C. 1927, chap. 97, to file his income tax returns on an accrual rather than a cash basis of accounting, if he so elects, and to be assessed for income tax thereon; and the other, whether the Minister has power to permit a taxpayer to file his returns on such basis and assess him accordingly.

The appellant resides in New Westminster, British Columbia. On February 13, 1931, he purchased certain lands and premises in that city from The T. J. Trapp Company, Limited, which had gone into voluntary liquidation, and on the same day executed a mortgage of \$106,000 in favor of the liquidator to secure the amount of the purchase price and interest thereon at the rate of 5% per annum. On February 28, 1931, the liquidator assigned this mortgage to the shareholders of The T. J. Trapp Company, Limited, in proportion to their holdings of shares in it, the amount to which the appellant was entitled being \$30,000. This was applied on the principal of the mortgage, leaving the appellant the registered owner of the property subject to a mortgage of \$76,000. On the premises there was a garage building which was rented to Trapp Motors Limited. The appellant was entitled to the rentals from this building and liable for payment of the mortgage and the interest thereon. In his income tax return for the year ending December 31, 1940, he included the rental income from the garage building but claimed as an item of expense the sum of \$3,800 as one year's interest on the mortgage, although as a matter of fact he had not paid it. At the trial he stated that the last payment of interest made by him was on January 10, 1938, and explained that his reason for not paying the interest was that he did not have it and that he was working out a plan of settlement for cash and kind with the shareholders of The T. J. Trapp Company, Limited, who were entitled to the mortgage. On the assessment this sum of \$3,800 was disallowed and added to his stated income.

An appeal from this assessment, confined to the question of disallowance of the unpaid interest, was taken to the Minister. In his notice of appeal the appellant claimed that the sum of \$3,800 was the mortgage interest which accrued during the taxation year in respect of property, the income of which was taxed under the Act, and was an expense, wholly, exclusively and necessarily provided for the purpose of earning the income; that his return of income for the taxation year 1940 was on an accrual basis; that he had always made his return of income on an accrual basis and elected to continue on that basis; that the disallowance of the sum of \$3,800 was unreasonable and not in accordance with the *Income War Tax Act*, and not in the discretion of the Minister, or, alternatively, an improper exercise of discretion by him. In his decision on the appeal the Minister affirmed the assessment on the grounds that the mortgage interest was not actually laid out or expended for the purpose of earning the income within the meaning of section 6(a) of the Act; that there is no provision in the Act permitting the taxpayer to elect to be taxed on an accrual basis; and that under section 47 of the Act the Minister shall not be bound by any return or information supplied by or on behalf of a taxpayer and, notwithstanding such return or information, the Minister may determine the amount of tax to be paid by any person.

In his notice of dissatisfaction, the appellant set forth further grounds of appeal, namely, that having adopted a return of income on an accrual basis he was justified in continuing that system and was not prohibited from so doing; that the sum of \$3,800 was properly deductible on an accrual basis; that it was deductible under section 5(b) as interest on borrowed capital used in his business to earn the income; and that section 47 did not authorize the Minister to determine the amount of the tax payable by the appellant on any basis other than as set forth in the *Income War Tax Act*.

In his statement of claim the appellant put forward still another claim, namely, that his return of income for the taxation years previous to 1940 was on an accrual basis and such method was accepted and ratified by the Minister. This was denied by counsel for the respondent. At the trial, evidence was given that the income tax returns of

the appellant for 1938, 1939 and 1940 had in fact been made on an accrual basis, and I accept this evidence. But there is nothing to justify the allegation that this method was accepted and ratified by the Minister. In the return for 1940, which was the only one before the Court, there is nothing to indicate that it was made on an accrual basis. Indeed, quite the reverse is the case. Item No. 23 on page 2 is headed "Gross Income from Rentals (give amount received from and address of each property)" and under this there is entered "net—as per statement attached" \$2,179.42). This is a clear statement that the net income had been "received" and there is nothing on the statement attached to show that it is made on an accrual basis and that the interest was not paid. In my opinion, any one looking at the return by itself would certainly conclude that it had been made on a cash basis, and there was nothing in it to lead the Minister to think otherwise.

It was argued for the appellant that section 3 of the *Income War Tax Act* defines income for the purposes of the Act as meaning "annual net profit or gain or gratuity"; that what is "net" profit or gain must be ascertained by the application of the recognized principles of good business and accountancy practice; and that the deduction of the interest on the mortgage, although it had not been paid, was justified by such principles. It may well be that the deduction of the interest, although unpaid, was in accord with good business and accountancy practice on the ground that the interest accrues from day to day and that accounting on an accrual basis in such a case as this more clearly reflects the true net profit or gain position of the appellant than accounting on a cash basis would do. But it is well established that for income tax purposes accountancy practice, however sound it may be, must give way before the provisions of the *Income War Tax Act*, and that if there is any conflict between them the provisions of the Act must prevail. The Act makes no reference either to the cash or to the accrual method of accounting and gives the taxpayer no right of election between them. Nor can it be said that the Act is a scientific document or that what is truly net profit or gain from an accountant's point of view is necessarily the same as taxable income under the Act. The Court is concerned only with the latter and the question

for it to determine in the present case is, not whether the deduction of the unpaid interest was in accord with the principles of good business and accountancy practice, but rather whether the appellant was entitled to it under the Act. If he was not, that is the end of the matter and the appeal must be dismissed.

Section 9 is the primary charging section of the Act, and subsection 1 provides for the assessment, levy and payment of the tax upon "the income during the preceding year" of every person, other than a corporation or joint stock company. The income is defined by section 3 as meaning "the annual net profit or gain or gratuity . . . directly or indirectly received by a person . . ." The income thus defined is made subject to the exemptions and deductions specified in section 5 and section 6 lays down the deductions that shall not be allowed in computing the amount of the profits or gains to be assessed. The taxpayer is, therefore, taxable not on his "net profit or gain" as it might appear to an accountant on an accrual basis of accounting, but on the net profit or gain that he has "received" during the preceding year.

In *Robertson Limited v. Minister of National Revenue*, [1944] Ex. C.R. 170 at 180, this Court held that the test of taxability of the income of a taxpayer in any year is not whether he earned or became entitled to such income in that year but whether he received it in such year, and the taxpayer has no right to have income received by him during a taxation year distributed for taxation purposes over the years in respect of which he may have earned or become entitled to such income. This means that he has no right to have his income taxed on an income receivable basis, but only on an income received basis, and it must, I think, follow that he is liable to tax only on such a basis and not on an income receivable basis. This was clearly settled in *Capital Trust Corporation Limited et al v. Minister of National Revenue*, [1936] Ex. C.R. 163; [1937] S.C.R. 192. In that case, a testator by a codicil to his will had directed that his son, who was one of his executors, should be paid "the sum of \$500 per month in addition to any sum which the Courts or other proper authorities may allow him in common with the other executors." The testator died on December 5, 1923, but the son did not receive any of

the monthly payments of \$500 until March 10, 1927; on that date, he received the sum of \$19,500, representing 39 payments of \$500 each from December 5, 1923, to March 5, 1927, and, subsequently, he received the monthly payment regularly until his death on July 16, 1932. His income tax returns for the years 1927 to 1932, filed by him or his executor, made no mention of these monthly payments of \$500. Subsequently, his estate was assessed in respect of them in addition to the amounts mentioned in the returns made and for the year 1927 the assessment included the \$19,500 received on March 10, 1927, as well as the monthly payments received during the balance of that year. An appeal was taken to this Court on the ground that the amount of \$500 per month was a bequest under a will under subsection (a) of section 3 of the *Income War Tax Act*, and that, in any event, the assessment in respect of the year 1927 should not be for more than the amount payable for that year. Angers J. held that the amounts in question were not a gift or bequest under section 3(a) of the Act but constituted additional remuneration to the son for his services as executor and, as such were taxable income. He also held that it was the intention of the legislature to assess income for the year in which it was received, irrespective of the period during which it was earned or accrued due, and pointed out that there was no stipulation in the *Income War Tax Act* providing for the apportionment of accumulated income, paid in one sum, over the period in respect of which it became receivable. The appeal to this Court was, therefore, dismissed. On appeal to the Supreme Court of Canada, the judgment of Angers J. was affirmed. It was argued before the Supreme Court that if the payments were to be treated as additional remuneration, then the assessments should be revised so as to allocate \$6,000 to each of the years in respect of which the amounts were payable, and the tax levied accordingly. The Supreme Court held that the appellant had no right to have this done. Davis J., delivering the judgment of the Court, said, at page 195:

"The statute here by section 3 defines income as 'income received' and by section 9 imposes the tax upon 'the income during the preceding year.' Unfortunately in this case the taxpayer is bound to pay a larger amount than

could have been levied and collected upon the same income had it been paid in instalments month by month as it became due and payable, but that cannot affect the liability plainly imposed by the statute."

If the taxpayer is not entitled to have his income assessed as it is receivable, then it follows, I think, that there is no authority to tax him on income that has accrued or is accruing but has not been received by him, either directly or indirectly. What is taxable is the income "received", not the income receivable, whether accrued or accruing.

The decision in the *Capital Trust Corporation* case (*supra*) is, I think, conclusive against reading the word "received" in section 3 of the Act as meaning or including "receivable." Since the taxpayer is not entitled to be taxed on the basis of the income receivable by him, whether accrued or accruing, and is liable to tax in respect of the income received by him during the year, regardless of when it accrued to or was receivable by him, it seems to me that the conclusion is inescapable, as long as the authority of the *Capital Trust Corporation* case (*supra*) remains unchallenged, that, under the Act as it stands, so far as receipts are concerned, a taxpayer is not entitled, as a matter of right, to be taxed on an income computed according to an accounting on an accrual basis.

Now we come to the question of deductible expenditures. Section 6(a) provides:

"6. In computing the amount of the profits or gains to be assessed, a deduction shall not be allowed in respect of

- (a) disbursements or expenses not wholly, exclusively and necessarily laid out or expended for the purpose of earning the income."

This is put in double negative form. While there is no positive statement anywhere in the Act as to what disbursements or expenses may be deducted, it follows by necessary implication that if disbursements or expenses have been wholly, exclusively and necessarily laid out for the purpose of earning the income, and are not otherwise excluded from deduction, they are deductible, for in such case they fall outside the excluding provisions of the section.

Counsel for the appellant contended that the words "laid out or expended" were referable to each of the words "dis-

bursements" and "expenses." In my view, the words "laid out" are referable to the word "disbursements" and the word "expended" to the word "expenses." A person "lays out" disbursements; they are not ordinarily spoken of as "expended"; and the term "expended" is, I think, referable only to the word "expenses." The contention of counsel was necessary to his further argument that the distinction between disbursements and expenses is that one is paid while the other is only incurred, and that the term "laid out" in the context necessarily includes "incurred." "Laid out or expended" would then mean "incurred or expended." I am quite unable to give effect to this argument and agree with the contention of counsel for the respondent that the words "laid out" and "expended" mean "actually paid out" and that if it had been intended to allow expenses that had merely been incurred but not paid, the terms used would have been "laid out, expended or incurred," or terms to the like effect. The term "incurred" is frequently used with regard to expenses and, in ordinary use, is sometimes equivocal in meaning; it may mean either that the expenses have been paid or that an obligation to pay them has been assumed. The fact that the word "incurred" is not used in the section strongly indicates that the expenses referred to are those that have been paid out. Nor can I think that the word "laid out" can include "incurred." Disbursements that have been laid out are those that have been made, not those that are to be made. Nor can the word "expended" be read as meaning or including "expendible." The words must be given their plain ordinary meaning and should not receive the meaning urged on behalf of the appellant. As I read section 6(a) disbursements that have not been made and expenses that have not been paid out do not fall outside the excluding provisions of the section or within the class of deductions allowed by the necessary implication from it. So that, as far as disbursements or expenses are concerned, it seems to me that a taxpayer has no right to deduct them in computing his taxable income unless they have been made or paid out.

It is obviously essential to the keeping of accounts on an accrual basis that in preparing the statement of receipts and expenditures from which the net profit or gain during the year is to be ascertained account should be taken of

amounts receivable on the one hand and amounts payable on the other. But since only income "received" is taxable and only disbursements or expenses that have been made or paid out can be deducted in computing the amount of profits or gains to be assessed, it follows that a taxpayer is not entitled, as a matter of right, under the *Income War Tax Act* as it stands, to elect whether he shall file his income tax returns on an accrual rather than on a cash basis and be assessed for income tax accordingly. He is liable to tax only on the net profit or gain or gratuity that he has received, either directly or indirectly, ascertained by deducting only disbursements or expenses made or paid out from gross income received and has not legal right to be taxed on any other basis.

This conclusion finds further support in section 6(d) which provides as follows:

"6. In computing the amount of the profits or gains to be assessed, a deduction shall not be allowed in respect of

(d) amounts transferred or credited to a reserve, contingent account or sinking fund, except such an amount for bad debts as the Minister may allow and except as otherwise provided in this Act;"

This was introduced in 1923. The reason for its introduction is not clear. Obviously if income tax returns are to be made on a cash basis and the taxpayer is taxable only on such basis there is no need for any allowance for bad debts. It is, I think, equally clear that if the taxpayer is entitled, as a matter of right, to make his returns on an accrual basis and to be taxed thereon he is entitled to an allowance for bad debts, for such an allowance is essential to a proper accounting on an accrual basis. But the taxpayer is not given any legal entitlement to an allowance for bad debts. The provision for the allowance appears in the section which specifies the deductions that "shall not" be allowed and is an exception to it. The taxpayer gets the benefit of an amount for bad debts only if the Minister allows it and not otherwise. As I see it, section 6(a) confirms the view that the taxpayer is not entitled, as a matter of right, to make his returns and to be assessed thereon except on a cash basis, and that if he files his returns on an accrual basis

and is assessed accordingly, this can happen only as the result of permission by the taxing authority.

This leads to the question whether there is any authority in the Act for such permission. It was argued by counsel for the respondent that a taxpayer has no right to file his income tax returns or to be assessed for income tax on an accrual basis unless the Minister so permits, and that in the present case no such permission had been given. While I have found that in fact the appellant's return was made on an accrual basis, I have also found that there is nothing in the return itself to indicate that it was made on such basis and I find further that there is no evidence to establish that any permission to make his return on such basis was ever given to the appellant by the taxing authority. Moreover, even if such permission had been given, it would not, in my opinion, help him.

It has been the practice of the taxing authority for a great many years to permit taxpayers in certain classes of cases to file their income tax return on an accrual rather than a cash basis if they so elect and indicate such election and to assess them for income tax on such basis. I have come to the conclusion that there is no authority, under the Act as it stands, for this practice. Counsel for the respondent contended that the Minister's powers under section 47 of the Act were wide enough to authorize the practice; it reads as follows:

"47. The Minister shall not be bound by any return or information supplied by or on behalf of a taxpayer, and notwithstanding such return or information, or if no return has been made the Minister may determine the amount of the tax to be paid by any person."

While the Minister has the power to determine the amount of the tax to be paid by any person, his power to do so is subject to the Act and is governed by it. The Act lays down a specific basis for taxation and the Minister has no right to use a different basis in determining the amount of the tax that a person is to pay. Parliament has decreed by section 3 that the basis of taxability of income is that of income received, as was held in the *Capital Trust Corporation case* (*supra*), and the Minister has no right to tax on the basis of income that has not been received; Parliament

has also laid down that disbursements or expenses shall not be deductible if they have not been made or paid out, and the Minister has no right to allow their deduction. It cannot have been intended by Parliament that, although it had fixed the basis of taxation, the Minister should have the right to change it, if in any case he should decide to do so. The basis of taxability is fixed by the Act, and section 47 does not, in my judgment, give the Minister any power to depart from it. Such a power would have to be conferred in clear and explicit terms before effect could be given to it and no such terms can be found in section 47. The view that the Minister may, under such section, permit a taxpayer to file his income tax returns on an accrual basis and assess him for income tax accordingly, notwithstanding the specific provisions of section 3 and section 6(a), is, in my opinion, quite untenable.

This leaves the case for permitting the filing of income tax returns on an accrual basis and assessing taxpayers accordingly dependent solely upon the implication involved in the exceptional provision of section 6(d) that an amount for bad debts may be allowed by the Minister. It might be argued from the inclusion of this provision in the act for an allowance, which would be necessary only when a taxpayer had included items of receivable income in his receipts, that the filing of returns on an accrual basis and assessment accordingly might be permitted, but if that were so, there would surely be some clear authority in the Act for such permission. I have been unable to find any such authority; it is, in my opinion, not contained in section 47; and no other source of authority was suggested by counsel. In view of the express provisions in the Act fixing the basis of taxability, it is, I think, inconceivable that Parliament should have intended a different basis, dependent upon the Minister's permission, to be discovered in the indirect implication involved in the exceptional provision in section 6(d) to which I have referred. The only explanation I can think of for the inclusion in the Act of the provision in section 6(d) for a permissive allowance of an amount for bad debts is that the draughtsman assumed that such a provision was desirable in view of the permissive practice that had been followed by the taxing authority and the Parliament adopted it on such assumption

without making any amendment of the basis of taxability as fixed by the Act.

The basis of taxability under the *Income War Tax Act* is different from that which exists under the *Income Tax Act*, 1918, of the United Kingdom. For example, Schedule D of that Act includes the following provision:

"1. Tax under this Schedule shall be charged in respect of—

- (a) The annual profits or gains arising or accruing—
 - (i) to any person residing in the United Kingdom from any kind of property whatever, whether situated in the United Kingdom or elsewhere; and
 - (ii) to any person residing in the United Kingdom from any trade, profession, employment, or vocation whether the same be respectively carried on in the United Kingdom or elsewhere; and
 - (iii) to any person, whether a British subject or not, although not resident in the United Kingdom, from any property whatever in the United Kingdom, or from any trade, profession, employment, or vocation exercised within the United Kingdom;"

In the cases that come under this part of Schedule D the basis of taxability is not "net annual profit or gain or gratuity received," as is the case in Canada, but "annual profits or gains arising or accruing." The difference is fundamental. Because of this difference it is quite unsound to apply English decisions on the subject of taxable income in the United Kingdom in the determination of taxable income in Canada under the *Income War Tax Act*. It might be quite proper to say in the United Kingdom, as Rowlatt J. did in *The Naval Colliery Co., Ltd. v. The Commissioners of Inland Revenue* (1926), 12 T.C. 1016 at 1027, to which counsel for the appellant referred, that "receipts include debts due" and "expenditure includes debts payable," but such a statement is not applicable in Canada under the *Income War Tax Act* in view of the decision in the *Capital Trust Corporation* case (*supra*).

The law in the United States on this matter is also very different from that in Canada. Section 41 of the *United States Revenue Act* of 1938 provides as follows:

- "41. The net income shall be computed . . . in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income . . ."

In the United States, while the taxpayer may keep his accounts and file his returns on a cash or on an accrual basis of accounting, as he elects, the essential requirement is that the method of accounting used by him shall clearly reflect his true net income. If it does, the Commissioner cannot change it, but if it does not, he may do so. The essential thing in the United States law is to ascertain what is truly the net income. There is a constitutional reason for this, for the Sixteenth Amendment prevents Congress from taxing as income what is not in fact income. The result is that, while net income from an accounting point of view may differ from taxable income under the Revenue Acts, sound accounting practice plays a much more dominant role in United States income tax law than it does in the Canadian law. If in any case the method of accounting on an accrual basis reflects the net income of the taxpayer, and the method of accounting on a cash basis does not do so, the accrual basis method governs.

It is generally conceded that in many cases, if not in most, the true net profit or gain position of a taxpayer, particularly if he is in business, cannot be ascertained otherwise than by an accounting method on the accrual basis. A person who has accounts receivable at the end of the year that are attributable to the earnings of such year and owes accounts payable for debts relating to the earnings of such year but keeps his accounts only on a basis of cash received and cash expended will frequently arrive at an amount of income "received" during the year that is not a reflection of his true net profit or gain for such year. But under the *Income War Tax Act*, as it stands, there is no place, as a matter of right, for the accounting method on an accrual basis, even if it does reflect the true net profit or gain of the taxpayer, and it must give way to the express provisions of the Act. Income tax law in Canada in this re

spect lags far behind that of the United Kingdom and the United States and runs counter to well recognized principles of sound business and accountancy practice.

The administrative practice of permitting certain classes of taxpayers to file their income tax returns on an accrual basis and assessing them for income tax accordingly, for that is all I think it is, has, no doubt, in many cases resulted in taxation on a more equitable and sounder basis than would otherwise be the case. It was, in effect, a needed income tax law reform by administrative action in the cases where such action was taken. But income tax law reform is not a matter for administrative action; it is a function that belongs exclusively to the appropriate legislative authority. It is, perhaps, not beyond the scope of the judicial function to suggest, under the circumstances, that the Act be amended with a view to coming nearer the objective of taxing what is truly net profit or gain than the Act as it stands now does; that the present basis of taxability be broadened to include income accrued or accruing as well as that received; that the taxpayer be entitled, as a matter of right, to elect under what method of accounting he shall keep his accounts and file his income tax returns and that he be assessed for income tax accordingly, with the necessary provision that the accounting method used must in each taxpayer's case be such as will clearly reflect his true net profit or gain, as is the case in the United States. In this connection it might be again pointed out as I did in *Robertson Limited v. Minister of National Revenue* (*supra*) that in the *Capital Trust Corporation* case (*supra*) both Angers J. in this Court and Davis J. in the Supreme Court of Canada commented upon the harshness and injustice of the result of the decision from which there was no escape in view of "the liability plainly imposed by the statute." If the appellant in that case had had the right of being assessed on the basis of the income as it accrued or became payable to him in each of the years in which he earned it, he would not have suffered the inequity that the state of the law imposed upon him.

Under the law as it stands, so far as this appeal rests on the ground that the income tax return of the appellant was properly made on an accrual basis of accounting and that he was entitled to be assessed for income tax accordingly, it cannot succeed.

I have not overlooked the fact that the Act contains some specific provisions in respect of amounts that have not been received or paid by the taxpayer; for example, section 11 puts certain amounts into the category of taxable income although they have not been received, and section 5 allows the deduction of certain amounts although they have not been paid. In all of such cases the matter is covered by specific statutory authority. Such specific provisions do not disturb the conclusions I have reached; indeed, they tend to confirm them.

There are also other grounds on which the appeal must fail. The appellant cannot show that the unpaid interest on the mortgage falls outside the excluding provisions of section 6(a), which I have already cited. There are two reasons why the deductions cannot be allowed. I have already mentioned one, namely, that the interest on the mortgage was not a disbursement or expense that was either "laid out" or "expended." That would be enough to prevent it from falling outside the exclusions of the section but there is also a further reason. Even on the assumption that the appellant was in the business of renting the garage and earning the rentals as the income from such business, and even if he had actually paid the interest, payment of it would not be part of the appellant's working expenses in the business of renting the garage nor would it be an expenditure "laid out as part of the process of profit earning" in the garage renting business, within the meaning of the test laid down by the Lord President (Clyde) in *Robert Addie & Sons' Collieries, Limited v. Commissioner of Inland Revenue*, [1924] S.C. 231 at 235, as adopted by the Supreme Court of Canada in *Minister of National Revenue v. Dominion Natural Gas Co. Ltd.*, [1941] S.C.R. 19. The interest would be payable even if the appellant did not rent the garage at all. The payment of the interest has nothing to do with the business of renting the garage. It becomes payable because of the covenant in the mortgage and this is not an obligation assumed in the course of or as part of the business of renting the garage. Nor would the payment of the interest, if it had been made, have been "directly related to the earning of the income" from the garage renting business within the meaning of the judgment delivered by Lord MacMillan in *Montreal Coke and*

Manufacturing Co. v. Minister of National Revenue, [1944] C.T.C. 94: *vide also Siscoe Gold Mines Limited v. Minister of National Revenue*, [1945] C.T.C. 397.

Moreover, if the payment had been made it would, in my opinion, clearly have been a payment on account of capital within the meaning of section 6(b) which reads:

"6. In computing the amount of the profits or gains to be assessed, a deduction shall not be allowed in respect of

(b) any outlay, loss or replacement of capital or any payment on account of capital or any depreciation, depletion or obsolescence except as otherwise provided in this Act;"

The payment of the interest would be the result of an obligation not of a current or business or revenue nature, but of a capital one, and it would have to be made to save the appellant's property from foreclosure. Such foreclosure would have extinguished the appellant's capital asset. The payment would be for the purpose of maintaining or preserving such capital asset. In the *Dominion Natural Gas Co. Ltd.* case (*supra*) the Supreme Court of Canada held that certain legal expenses of the company incurred and paid in defending its right to supply gas in the City of Hamilton were not deductible and one of the grounds for so holding was that they were a capital expenditure: *vide also Siscoe Gold Mines Limited v. Minister of National Revenue (supra)*. Indeed, the argument of counsel for the appellant that it was interest on borrowed capital used in the business, within the meaning of section 5(b) of the Act, admits that, if it had been paid, it would have been a payment on account of capital. As such it would be excluded from deduction by section 6(b) unless it were excepted from such exclusion by the concluding words of the section "except as otherwise provided in this Act."

There remains only the question whether the appellant tion 5(b) which reads as follows:

"5. 'Income' as hereinbefore defined shall for the purposes of this Act be subject to the following exemptions and deductions:—

(b) Such reasonable rate of interest on borrowed capital used in the business to earn the income as the Minister in his discretion may allow

notwithstanding the rate of interest payable by the taxpayer, but to the extent that the interest payable by the taxpayer is in excess of the amount allowed by the Minister hereunder, it shall not be allowed as a deduction and the rate of interest allowed shall not in any case exceed the rate stipulated for in the bond, debenture, mortgage, note, agreement or other similar document, whether with or without security, by virtue of which the interest is payable."

The draftsmanship of the section is careless. What is said to be exempted or deducted is "such reasonable rate of interest on borrowed capital used in the business to earn the income as the Minister in his discretion may allow . . .", whereas it is obvious that what is meant is "interest on borrowed capital used in the business to earn the income at such reasonable rate as the Minister in his discretion may allow . . .". It is interest, not a rate of interest, that is to be excepted or deducted.

Section 5(b) must be interpreted in the light of its complete and true context. It is not sound construction, in my opinion, to consider it solely from the point of view of its inclusion in section 5, as a statement of one of the exemptions and deductions to which "income" as defined in section 3 shall be subject. It must also be considered in the light of its context as an exception to the excluding provisions of section 6(b), which I have already cited. It is obvious that section 5(b) is one of the provisions of the Act that comes within the concluding words of section 6(b), "except as otherwise provided in this Act," and its place as such in the scheme of the Act must not be overlooked. It is by reason of such exception that interest on borrowed capital used in the business to earn the income falls outside the exclusions of section 6(b). It would have been just as easy to specify "interest on borrowed capital used in the business to earn the income" as an exception to the exclusions of section 6(b) in section 6(b) itself as to provide for it otherwise in the Act, either in a substantive section or in one of the paragraphs of section 5; and the effect of the provision must be the same, wherever it is placed. The essence of the matter is that section 5(b) is an exception

to section 6(b) and that without it, section 6(b) would be the governing section.

The onus is on the appellant to show that his case comes within the terms of section 5(b); he seeks the benefits of an exceptional provision in the Act and must comply with its conditions. The principles of construction to be applied are well established. In *Wylie v. City of Montreal* (1885), 12 Can. S.C.R. 384 at 386, Sir W. J. Ritchie C.J. said:

"I am quite willing to admit that the intention to exempt must be expressed in clear unambiguous language; that taxation is the rule and exemption the exception, and therefore to be strictly construed."

And this Court, in construing another paragraph of section 5, namely, paragraph (k), in *Lumbers v. Minister of National Revenue*, [1943] Ex. C.R. 202 at 211; [1943] C.T.C. 281, stated the rule to be applied as follows:

"in respect of what would otherwise be taxable income in his hands a taxpayer cannot succeed in claiming an exemption from income tax unless his claim comes clearly within the provisions of some exempting section of the *Income War Tax Act*: he must show that every constituent element necessary to the exemption is present in his case and that every condition required by the exempting section has been complied with."

The judgment of the Supreme Court of Canada in the same case, [1944] C.T.C. 67, while not referring to this statement of the rule fully supports it.

If the appellant is to succeed he must be able to show that section 5(b) allows the deduction of the interest when it is payable but has not been paid. As I read the section by itself, there is nothing in it that will help the appellant. It is not specified in the section whether the interest must have been paid in order to be deductible or whether it is deductible when it has become payable but has not been paid. If the case were to rest there and no other clue were available the appellant's claim would fail, for the general scheme of the Act, taxing income on the basis of income "received," would govern. The amount of the interest having been received by the appellant and not yet laid out or expended would have to be regarded as income "received" by him during the year and, therefore, taxable in his hands.

Under the circumstances, it would not be proper to construe section 5(b) as allowing the deduction of unpaid interest, for such a construction would be an enlargement of an exemption provision beyond the scheme of the Act. No such enlargement is permissible in the absence of clear terms authorizing it, and there are no such terms.

Moreover, no light is shed on the question by the other paragraphs of section 5. The statutory requirements for the deductibility of the amounts specified in its paragraphs are not uniform; in most cases it is a condition that the amount to be deducted must have been paid, but in some it is deductible if payable or accruing. The statutory conditions for deductibility are specified in each of the paragraphs of section 5, except in paragraph (b).

Since section 5(b), considered by itself, does not answer the question whether interest on borrowed capital used in the business to earn the income can be deducted if it is payable but has not been paid, the answer must be sought elsewhere. It will be found, I think, if section 5(b) is read in its true light as an exception to the excluding provisions of section 6(b). If section 5(b) were not in the Act, it is clear, I think, that even if the appellant had paid the interest on the mortgage he would not have been entitled to deduct it. It would not have fallen outside the exclusions of section 6(a) for the two reasons already mentioned and it would have fallen squarely within the exclusions of section 6(b) as being a "payment on account of capital." It is also clear that section 6(b) in excluding "any payment on account of capital" must *a fortiori* also exclude any amount payable on account of capital. If the appellant could not have deducted the interest even if it had been paid, there was no possible right by which he could have deducted unpaid interest. It is only by virtue of the exception that he can have any right of deduction at all. How far does the exception extend? Does it include interest payable or is it confined to interest that has been paid? The answer, in my opinion, is to be found in the words "any payment on account of capital," contained in section 6(b). If the exception with which we are concerned had been set out in section 6(b) itself immediately after the words mentioned the exclusion and the exception to it would have been stated as follows, namely, "any payment on ac-

count of capital except interest on borrowed capital used in the business to earn the income at such reasonable rate as the Minister in his discretion may allow” Read in that light, as I think it should be, the meaning of section 5(b) becomes quite clear. Section 6(b) excludes from deduction “any payment on account of capital” but provides for an exception to such exclusion by the words “except as otherwise provided in this Act.” These words contemplate only exceptions of the same kind as the specific exclusions set out in the section. The exception carved out by section 5(b) is, therefore, of the same kind as the exclusion to which it is an exception, that is to say, it must be some kind of a “payment on account of capital.” These words govern the kind of exception that is otherwise provided for in the Act. The exception extends only to interest that amounts to a payment on account of capital; it is, therefore, confined to interest that has been paid; and does not include interest that is payable but has not been paid, for such interest cannot be a “payment” on account of capital. Such a construction of section 5(b) is necessary in order to bring its subject matter outside the exclusion of section 6(b) and within the exception contemplated by it, and there is nothing in section 5(b) itself that is inconsistent with it. It was, therefore, not necessary to specify in section 5(b) that the interest mentioned in it must have been paid in order to be deductible; that was a condition precedent to its deductibility inherent, in the absence of clear terms to the contrary, in section 5(b) as one of the exceptions referred to in the concluding words of section 6(b). It is, in my opinion, clear that section 5(b) allows the deduction of interest on borrowed capital used in the business to earn the income only when the interest has been paid; and that no deduction is allowed in respect of unpaid interest, even although it has become payable or is accruing from day to day.

That being so, since the appellant did not pay the interest on the mortgage, he cannot show compliance with the conditions required by section 5(b) and is not entitled to the benefit of its provisions. On this ground as well as on the others mentioned the appellant fails. The Minister was right in disallowing the deduction of the unpaid interest on the mortgage and the appeal must be dismissed with costs.

Calculation of Corporation Income Tax and Excess Profits Taxes

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A NUMBER of companies find it difficult to pay income taxes; some companies even have trouble figuring out how much should be paid, so we trust that the following mathematical formulae will be of interest. The numbers in the margin refer to the principal formulae which are summarized later in this article.

1945 Taxation Year

Adopting "T" to represent taxable income, the corporation income tax payable by companies under the first schedule of the income war tax act is 18% of T, or .18 T. The 12% tax payable under the third part of the second schedule of the excess profits tax act, 1940, becomes .12 T, and the 10% payable under the first part .10 T. Combined taxes payable by a company not subject to the second part of the second schedule of the Excess Profits Tax Act amount to

- (1) $.18 T + .12 T + .10 T = .40 T$.

Adopting "S" to represent standard profits, and assuming that no special inventory depreciation reserve is to be set up, or liquidation dividends are introduced to confuse the issue, the tax payable under the second part becomes 100% of (T - S) minus 30% of (T - S) = .7 (T - S), and the combined tax for a

- (2) company in this category totals $.18 T + .12 T + .7 (T - S) = T - .7 S$. Of this amount the refundable portion is equal to 20% of the profits above the point where $.10 T = .7 (T - S)$. i.e. where $T =$

- (3) $116\frac{2}{3}\% S$, so the refundable portion = $.2 (T - 1.16\frac{2}{3} S) = .2 T - .23\frac{1}{3} S$. The net combined tax is

- (4) thus $(T - .7 S) - (.2 T - .23\frac{1}{3} S) = .8 T - .46\frac{2}{3} S$. The net tax paid under the second part of the second schedule would work out as follows: $.7 (T - S) - (.2 T - .23\frac{1}{3} S) = .5 T - .46\frac{2}{3} S$.

The effect of securing an increase in standard profits from S to S_1 , for a company coming under the second part, before allowing for the refundable portion would

be $.7(T - S_1) - .7(T - S) =$ a reduction of $.7(S_1 - S)$ in the amount paid. The net effect after allowing for the refundable portion would be $(.5 T - .46\frac{2}{3} S_1) - (.5 T - .46\frac{2}{3} S) =$ a reduction of $.46\frac{2}{3} (S_1 - S)$ in the tax paid. Thus for each \$1,000 increase in standard profits the gross amount accruing to the corporation for the 1945 taxation year is \$700.00, and the net amount \$466.66.

By using formula (2) developed above for total tax payable under the Income War Tax Act, and under the Excess Profits Tax Act the reduction in amount paid with a revised standard, before allowing for

- (5) refundable, becomes $(T - .7 S_1) - (T - .7 S) = .7 (S_1 - S)$ which is of course equal to the saving shown above for the tax payable under the second part of the second schedule, as this is the only part affected by the change in the standard profits. The net saving after allowing for refundable becomes
- (6) $(.8 T - .46\frac{2}{3} S_1) - (.8 T - .46\frac{2}{3} S) = -.46\frac{2}{3} (S_1 - S)$ also as shown above.

The difference between total taxes paid by a company taxable under the second part of schedule two of excess profits tax act, and one taxable under the first part would be as follows: Before allowance for re-

- (7) fundable $= (T - .7S) - .4 T = .6 T - .7 S$ which it will be noted is equal to 3 times the refundable portion of $.2 T - .23\frac{1}{3} S$. After allowance for re-
- (8) fundable $(.8 T - .46\frac{2}{3} S) - .4 T = .4 T - .46\frac{2}{3} S$ which is equal to 2 times the refundable portion.

1946 Taxation Year

Most corporations paying excess profits taxes for 1946 will earn in excess of \$5,000, so the total income tax and excess profits tax payable will be

- (9) $.18 T + .22 T = .4 T$ if taxable only under the first part of the second schedule and $.4 T + .2 (T - 1.16$
- (10) $\frac{2}{3} S) = .6 T - .23\frac{1}{3} S$ if taxable under the second part. The difference in the amount of tax paid is thus
- (11) $(.6 T - .23\frac{1}{3} S) - .4 T = .2 T - .23\frac{1}{3} S$.

A comparison between the rates of tax for 1945 and 1946 is interesting. Applying the formulae developed above to the two periods the reduction in the amount of income and excess profits tax for a company under

parts one and two of the second schedule for 1946, and parts three and two for 1945 is as follows:

- (12) (a) before allowing for refundable: $(T - .7 S) - (.6 T - .23\frac{1}{3} S) = .4 T - .46\frac{2}{3} S$ which it will be noted $= 2(.2 T - .23\frac{1}{3} S) = 2$ times the 1945 refundable portion formula.
- (13) (b) after allowing for refundable: $(.8 T - .46\frac{2}{3} S) - (.6 T - .23\frac{1}{3} S) = .2 T - .23\frac{1}{3} S =$ the 1945 refundable portion formula.

Thus the narrower the spread between taxable income and standard profits the smaller is the actual tax saving. Where 20% of T and $23\frac{1}{3}\%$ of S are equal, there is no net reduction at all. This is of course the "break-even" point for calculating the refundable portion formula — i.e. where $.10 T = .7 (T - S)$ or $.6 T = .7 S$ and $T = 116\frac{2}{3}\% S$.

- The net effect of increasing standard profits for 1946
- (14) from S to S_1 now becomes $(.6 T - 23\frac{1}{3} S_1) - (.6 T - .23\frac{1}{3} S) = .23\frac{1}{3} (S_1 - S)$. An increase in standard profits of \$1,000 thus returns a net to the company of \$233.33 against the \$466.66 from a \$1,000 upward revision in 1945.

SUMMARY

The principal formulae developed, or discussed above may be summarized as follows where

Taxable Income = T

Standard Profit = S

1945 Tax Year

- (1) Total tax payable under the first schedule of the Income War Tax Act, and the third and first parts of the second schedule of The Excess Profits Tax Act, 1940 $= .18 T + .12 T + .10 T = .40 T$. Combined income tax and excess profits taxes payable under the
- (2) first schedule of the income war tax act, and the third and second part of the second schedule of The Excess Profits Tax Act, 1940 $= .18 T + .12 T + .7 (T - S) = T - .7 S$.
- (3) Refundable portion $= 20\% (T - 116\frac{2}{3}\% S) = .2 T - .23\frac{1}{3} S$.
- (4) Net tax paid under (2) above after deducting refundable portion $= (T - .7 S) - (.2 T - 23\frac{1}{3} S) = .8 T - .46\frac{2}{3} S$.

- (5) Effect of securing an increase in standard profits from S to S_1 , on combined taxes paid under (2) above, i.e. before allowing for refundable = $(T - .7 S_1) - (T - .7 S) = -.7 (S_1 - S)$.
- (6) Net effect of revised standard from S to S_1 , on combined taxes paid under (4) above, i.e. after allowing for refundable = $(.8 T - .46\frac{2}{3} S_1) - (.8 T - .46\frac{2}{3} S) = -.46\frac{2}{3} (S_1 - S)$.
- (7) Difference between total taxes paid by a corporation taxable under second part of second schedule of Excess Profits Tax Act, before allowance for refundable, and taxes paid by a company taxable under part one = $(T - .7S) - .4 T = .6 T - .7 S = 3$ times refundable portion.
- (8) Difference in (7) after allowing for refundable = $(.8 T - .46\frac{2}{3} S) - .4 T = .4 T - .46\frac{2}{3} S = 2$ times refundable portion.

1946 Tax Year

- (9) Combined taxes payable under Income War Tax Act and Excess Profits Tax Act, 1940, under section two of first part of second schedule = $.18 T + .22 T = .40 T$.
- (10) Combined tax payable under Income War Tax Act and Excess Profits Tax Act under first and second parts of second schedule = $.18 T + .22 T + .2(T - 1.16\frac{2}{3} S) = .6 T - .23\frac{1}{3} S$.
- (11) Difference in tax paid under (9) and (10) above = $(.6 T - .23\frac{1}{3} S) - .4 T = .2 T - .23\frac{1}{3} S =$ refundable portion formula 1945.
- (12) Reduction in combined income and excess profit taxes payable for company coming under parts one and two for 1946, and parts three and two for 1945, before allowing for 1945 refundable = $(T - .7 S) - (.6 T - .23\frac{1}{3} S) = .4 T - .46\frac{2}{3} S = 2(.2 T - .23\frac{1}{3} S) = 2$ times refundable portion formula.
- (13) Reduction after allowing for 1945 refundable in (12) above $(.8 T - .46\frac{2}{3} S) - (.6 T - .23\frac{1}{3} S) = .2 T - .23\frac{1}{3} S =$ refundable portion formula.
- (14) Net effect of increasing standard profits for 1946 from S to S_1 = $(.6 T - .23\frac{1}{3} S_1) - (.6 T - .23\frac{1}{3} S) = -.23\frac{1}{3} (S_1 - S)$.

The Annual Report of the Bank For International Settlements

By J. P. Day, D. Phil.

Department of Political Economy, McGill University

(From the Financial Times, March 1, 1946)

THIS latest annual report of the Bank for International Settlements was published in Basle in the autumn of 1945, and has recently reached Canada. As usual, the report rewards the reader not only because the broad sweep of the narrative contributes to a better perspective of world developments, but also because, embedded in this, there are many interesting and sometimes surprising facts.

The opening section is on the legacies of the war in individual countries. Though the United Kingdom lost fewer lives in this war than in the first world war, the report states "the general resources of the nation were unstintingly devoted to the war effort" and, as evidence, adduces the facts that private outlay on goods and services for personal consumption dropped from £4,153 million in 1938 to a comparable figure, in pounds of equal value, of £3,450 million in 1944. More serious, perhaps, is the drop in private capital formation from £550 million in 1938 to £154 million in 1944. It is interesting, rather than gratifying, to notice that neutral Eire has become, with the possible exception of Switzerland, the world's largest creditor country in proportion to population. The war effort in the United States is estimated to have cost that country in working time lost through service in the armed forces and the manufacture of munitions, the equivalent of 47.5 million man-years, and the report calls it remarkable, as indeed it is, that this loss has been covered in full by an increase in production above the pre-war level. In the United States there was a net loss of five million persons from agriculture, one half being workers and one-half dependents, yet the agricultural output reached a new record in every successive year of the war, which clearly indicates a previous redundancy in the farm population.

Canada's external indebtedness has been reduced by 1,500 million dollars during the war period, and it is stated that our country is now the fifth industrial country in the world "after having been almost without any industry in

1913." If that last phrase does not sound too kind, the report compensates for it by listing, as the favourable circumstances which have helped Canada to show how quickly new enterprises can be launched in our time, technical and financial ability, an adequate number of workers anxious to be trained, supplies of raw material at reasonable prices, and well-to-do customers to buy what is produced. Australia is actually the most urbanized country in the world, 31% of its population living in the two largest cities. South Africa has repatriated the whole of the government sterling debt and covered a greater percentage of war expenditure by current revenue than any of the other active beligerants. India has become a net creditor country. In Malaya, it has been found that, in general, the rubber trees have not been destroyed and the plantations are expected to yield rubber again in the course of 1946.

In the section on general problems arising out of the war, the estimate is given that the total war expenditure borne by the different treasuries was fully four times as high as the cost of the first world war. In spite of the tremendous destruction of the war, the suggestion is made that economic disorganization may again prove to be a greater handicap than material destruction. In contrast to the popular idea that there exists a shortage of everything, the report says "although shortage may still occur in certain products, the general task of the moment is to ensure the orderly marketing of a great variety of surplus stocks", and they quote, as an extreme case, wool, and mention the calculation that, with the same exportable surplus from new clips as before the war, it will take thirteen years to dispose of the existing surplus, even if there is a 12% increase in consumption of apparel wool over the pre-war intake. This section concludes with the remarks: "With only a few exceptions, the situation on the world's commodity markets is beginning to be characterized by sufficient and, in some cases, abundant supplies. As regards countries which have their transport system in good working order and a sufficiency of foreign exchange at their disposal, there will soon be no further need of control for the purpose of allocating short rations of raw materials between different areas and between individual firms and consumers."

Currency Problems

There is an interesting section on the restoration of order in the currencies of the liberated countries. Always the people had to declare their holdings of notes: the old notes then lost their quality of legal tender and had to be exchanged, under varying conditions, for notes of a new issue. One reason for this was to make worthless the note holdings that might have been taken out of the country into Germany; another was that the large holdings in the hands of black marketeers and other war profiteers would also become worthless since the holders would be afraid to declare them. Furthermore, there was usually a blocking of a proportion of the new credits in notes with the purpose of reducing inflated prices, though the report is not optimistic about this and says the exchange of notes is of no real avail for bringing down the excessive black market prices before goods actually begin to come in.

Turning to countries not occupied by enemy forces, and using an index number based on 1939 as 100, the notes in circulation at the end of June, 1945 are represented for the United Kingdom by 158, for the United States by 380, and for Canada by 455. The report seems mildly surprised over our lavish issues: "Circulation in the United States shows a rise of 280%. Canada has experienced an even more rapid advance and its circulation has risen by 355%, and this notwithstanding the fact that the Canadian price control can be regarded as unusually successful, the official cost of living showing an increase of about 20%". Is there a message for us in their later statement: "A rapidly rising note issue remains a danger signal not to be treated lightly by the authorities"? The country with the smallest currency inflation since 1939 is Uruguay, but Uruguay always does well out of world wars, and always will so long as the troops are fed on bully beef.

With regard to the nationalization of the Bank of England, the report rather cannily remarks that it is an interesting proposal, but, reading between the lines, it seems reasonable to deduce that they think it a wanton stupidity. Quoting the Eire Commission of Inquiry into Banking, Currency and Credit that "experience has shown that political bodies time after time have made undue use of the credit facilities of central banks, often to the extent of destroying

the value of the national currency", and that it is by no means easy to set up a central bank with the necessary independence, prestige and ability, the inference is that the one country which had so succeeded after 250 years' effort is rather stupid to spoil it.

Public Finance

The section on public finance shows uneasiness over the increase of national debts. It is pointed out that, even in the United States and the United Kingdom, the outstanding government floating debts in the autumn of 1945 were as high as, or higher than, the total government debts of these two countries in the summer of 1939. In the United States, the federal debt is approaching a figure equal to two years' national income, while in the United Kingdom the debt is larger than two and a half years' national income. The report admits the harsh necessities of war, but warns that in peacetime "creation of credit to cover budget deficiencies can easily distort the whole economic and commercial policy—as so many countries have discovered in the past". Greece has added another example to the sorry story of hyper-inflation: when the country was liberated in October, 1944, the price of bread was two million times the pre-war price!

There is a section on Bretton Woods which, although running to eleven pages, gives an account perhaps more lucid and compact than any of the many other attempts at a summary exposition which have been made.

The sections on international trade and on supply and movements of gold do not say much that is not already accepted. The hope that the commercial policy of the United States may not be so foolish in the future as it has been in the past is rather delightfully expressed by: "It would seem as if public opinion in the United States has been much impressed by the fact that the economic policy applied in the first part of the inter-war period and evidenced by such tariff-raising measures as the McCumber-Fordney Act in 1922 and the Hawley-Smoot Act in 1930 did not avail to save the American economy from participation in a world-wide depression or even to reduce the degree of unemployment as compared with other countries", and the report emphasizes that "American commercial policy must in future be as much concerned with attaining a high level of imports as with the promotion of exports—quite apart

from the country's interest as one of the world's great creditor nations". I think there should be lasting pride to Canadians in the recollection that of Canada's total financial help to the United Nations during the war, one-third only has been in the form of loans and repatriations, and two-thirds of it represents outright contributions.

Prices and Employment

On prices and employment, there is a needful sanity in the remark: "While a continued price stability is eminently desirable and, if secured, holds out the hope that a grave post-war crisis may be avoided, it may be just as well to remember that in some respects price increases may have quite useful results". As to wages, a strong plea is made for adequate explanation to the workers: "People are not unreasonable: but they want to be sure they are not being misled or unfairly treated", and it is urged "the least that can be done is to explain, by adducing facts, firstly, that government expenditure for the time being remains almost at the same high level as during the war, no 'money' having been as yet set free; secondly, that the people's ordinary requirements can be effectively met only when more consumers' goods come in the market, which necessarily takes time".

In the section on interest rates and stock exchange there is much of value and there is a wealth of significance in the statement that, for a cheap-money policy to be effective, government securities, even when carrying only a low interest rate, must be quoted close to par.

The couple of pages under the heading conclusion deal with the planned economy advocates. Pointing out that well over 80% of the economic activity in the countries of Western Europe and the New World is due to private enterprise, the report warns "it is reasonable that measures should be taken to prevent undesirable developments by exercising control and by giving positive stimuli when such are needed; but, if a system of control or other intervention were to impede current business or investment activity, it would deprive a society essentially based on private enterprise of its motive power without supplying any other driving force".

From the list of the board of directors of the bank one misses the familiar name so long there of Montagu Norman,

now replaced by Lord Catto of Cairncatto. One also misses the German and Japanese members, who included Walther Funk, with reference to whom there is the pregnant footnote that "the legal consequences arising from the situation at the date of this report remain to be determined".

Whatever may happen to the Bank for International Settlements in the light of the Bretton Woods proposals, it will be a calamity if the accumulated expert knowledge of the bank's staff, who have been responsible *inter alia* for these invaluable annual reports, is allowed to be dissipated and wasted.

DISALLOWANCE OF EXPENSE

Wrights' Canadian Ropes Limited, *Appellant*
and

The Minister of National Revenue, *Respondent*
The Supreme Court of Canada. January 24, 1946.

The appellant company paid commissions, in accordance with the terms of an agreement, to an English company, Wrights' Ropes Limited, in the years 1940, 1941, and 1942 of \$17,381.94, \$29,325.85, and \$39,480.91, respectively. The Minister of National Revenue exercised his discretion under section 6(2) of the Income War Tax Act and disallowed that portion of the commissions paid in each year which was in excess of \$7,500. The assessments for the years in question were appealed to the Exchequer Court of Canada, but the appeal was disallowed (Cameron, J., August 3, 1945. See THE CANADIAN CHARTERED ACCOUNTANT, October, 1945). This appeal was then taken to the Supreme Court of Canada.

The Court held, Kerwin, J., dissenting, that the case be referred back to the Minister under the provisions of section 65(2) of the Income War Tax Act.

The appellant was entitled to have produced to him, before the assessments were made, the report of the local inspector which was before the Deputy Minister when he exercised his discretion, and the report should have been filed with the Exchequer Court under section 63(g) when the assessments were appealed to that Court.

The facts and agreements before the Court did not "provide a basis upon which a discretionary determination can be made that the items are excessive within the terms of section 6(2)".

Current Accounting Literature

By Frank S. Capon, C.A.

Montreal, P.Q.

H G. PETERSON, of U. S. Steel has presented an interesting article on the co-ordination of financial planning with external economic conditions in the 1st March N.A.C.A. Bulletin. The importance of estimating the company's share of the total forecast market for each type of product is clearly set forth, together with the method of computing the break-even point in the volume of output of each line, and the effect of variations in demand for each type of product. The whole may be summed up as integrated financial and market budgeting.

Cost Accounting for Laundries

Another specialized cost accounting problem, that of costing in the laundry industry, is dealt with by John Caruthers in the above bulletin. The economic importance of service industries and the special cost angles peculiar to laundries are the main features of this article.

Standard Costs

The entire 1st April N.A.C.A. Bulletin is devoted to problems of standard costs. Titles of the four articles which are self-explanatory are as follows:

- (a) Standard costs and their relation to cost control.
- (b) The relationship between standard and actual costs.
- (c) Development and maintenance of standards.
- (d) Useful by-products of a standard cost routine.

During the war the development of standard cost principles suffered a set-back, partly because of the concentration of accountants on pressing problems of getting out current work, and partly because of the emphasis placed by the government on historical costs. The war is over, however, and in the period of intensive competition into which we are now headed, it will be of the utmost importance to get maximum value out of cost data, whether historical or pre-determined. In recognition of the advent of a new phase of industrial accounting, the National Association of Cost Accountants has rendered a signal service in collecting

this excellent series of four articles on standard costs in one bulletin.

Annual Report Features

The 1945 annual report of International Harvester Co. is one of many U.S. annual reports notable for the wealth of financial information provided. Apart from a six-year comparison of summary balance sheets and income statements, a complete analysis of all reserve accounts, a detailed statement of changes in property accounts, and two pages of explanatory notes attached to the balance sheet, a thumbnail sketch of financial results, taxation, capital expenditures and other statistics is included as a frontispiece. Standard Brands Inc. have also included a five-year comparative summary of key financial statistics on the first page of their annual report for 1945, together with an excellent statement of source and disposition of funds. American Rolling Mills Company has taken one step recommended recently by many accountants—the income statement is divided into two parts, the first covering normal recurring items and the second including those special non-recurring items which we are so prone to take direct to surplus. Net income for the year carried to surplus, therefore, includes normal, abnormal, recurring and non-recurring items.

Future of the Profession

The editorial in the 16th March issue of "The Accountant" on the future of the accounting profession contains much food for thought. After pointing out the tremendous contribution to virile and constructive thinking that will be supplied by those of our members who have been through the crucible of war, some of the more recent difficulties of accountants are discussed, particularly those arising out of increased complexity of taxation, government controls and regulations. Finally, one all important point is made—"it is the internal accounting of a business unit that conditions the efficiency of management, and it is the internal accounting that should attract the concentrated attention of accountants".

Economic Aspects of Accounting

Constant changes in the value of money make it extremely difficult for accountants to produce financial state-

ments which reflect a company's position at a given date, or the results from operations for a given period, in terms of real wealth. Money totals do not represent wealth, but are only indications of the magnitude of substance, and while money values change the substance remains stable, apart from depreciation or depletion. There have been an increasing number of articles pleading for accounting reforms which will permit the compilation of more realistic statements and one of the shortest but most constructive is that by F. S. Bray in the 16th February issue of "The Accountant" under the heading "Maintenance of Real Capital".

Cost and Value in Accounting

Along a similar vein, William A. Paton discusses the relationship between cost and value in the March issue of "The Journal of Accountancy". While emphasizing the importance of value rather than cost, in expressing current transactions and non-permanent resources, the author explains that the cost concept continues to be the accepted basis for fixed asset and depreciation accounting. The importance of values cannot be overstated, if accounting statements are to give true reflections of actual events, and it is to be hoped that the argument between replacement costs and historical costs for fixed asset accounting never will be ended, as it is by participation in such arguments that accounting students acquire their fundamental knowledge.

Fixed Asset Valuations

In the March issue of "Accountancy", Mr. F. S. Bray has published a short article making a further contribution to the continuing discussion between accountants and economists on fixed asset valuations. After presenting a very brief summary of the two opposing views, Mr. Bray suggests the attachment to financial statements of a schedule covering fixed asset valuations to meet the objections of economists. We cannot escape the fact that the economists have a very valid point, and Mr. Bray suggests what appears to be at least a compromise solution.

Office Methods and Operations

All industrial accountants, and those professional accountants who are advisers on procedure and routine in

clients' offices, will be interested in the new department on office methods and operations, edited by George H. Sherwood, commencing in the March "Journal of Accountancy". Many time-saving suggestions are made for streamlining and uniforming office procedures, and readers are asked to contribute suggestions for future issues.

Industrial Engineering

"Industrial engineering is a process of the finding, analysis, and interpretation of facts leading to the formulation of a realistic program for the solution of business problems". This definition, included in an article by Mason Smith in the March issue of "The Controller", illustrates the value of industrial engineering, in which professional accountants are becoming more and more active.

Canadian Master Tax Guide

The first issue of this new type reference book on Canadian federal taxation is now available (CCH Canadian Limited—\$3), and fills a gap in our text books that has remained open far too long. Our tax laws are explained in a clear concise text, divided into well defined sections by subjects and admirably indexed. Where the more important published rulings represent, in fact, the law on a given point, the actual rulings are included in the text, and the whole is cross-referenced to the CCH consolidation of the Income War Tax and Excess Profits Tax Acts. Here is a book that tells you clearly and quickly what is the tax position under any particular circumstances, thus obviating the necessity of referring to the legalistic and cumbersome working of the acts themselves. It includes tax rate tables, deduction tables, succession duty tables, tax conventions, companies act fees, stock transfer taxes, sales and amusement taxes, and all other federal tax problems affecting Canadian companies and individuals. While it is inevitable that first editions of such standard reference books will contain faults in drafting, and will be subject to criticism as to set-up, the Canadian Master Tax Guide will be found an invaluable companion to the consolidated tax acts by all accountants who are called on to face tax problems in their everyday duties.

INCOME ACCUMULATING IN ESTATE

The Executors of the Will of the Honourable Patrick Burns,
deceased, *Appellant*
and

The Royal Trust Company, named in the Will of the said Honourable Patrick Burns as Trustee for Burns Memorial Trust; The Father Lacombe Home at Midnapore; The Governing Council of the Salvation Army Canada West; The Trustees of the fund to be administered by the City of Calgary for the benefit of poor, indigent and neglected children under the Will of the Honourable Patrick Burns; The Trustees of the fund to be administered for the benefit of widows and orphans of members of the Police Force in the City of Calgary under the Will of the Honourable Patrick Burns; The Trustees of the fund to be administered for the benefit of widows and orphans of members of the Fire Brigade of the City of Calgary under the Will of the said Honourable Patrick Burns, *Added Appellants*,

and

The Minister of National Revenue, *Respondent*
Exchequer Court of Canada, Cameron, Deputy Judge.
January 8, 1946.

The appellant executors were assessed for the years 1938, 1939, 1940 and 1941 on all the income accumulating in their hands under the provisions of subsections 2 and 4(a) of section 11 of the Income War Tax Act. The assessments were appealed but were affirmed by the Minister and this appeal was brought to the Exchequer Court in which it was contended, among other things:

1. That 33% of 40% of the income accumulating in the estate in the years concerned accumulates for the benefit of the Burns Memorial Trust, and that this trust is a charitable institution;

2. That the institutions beneficially entitled to the Burns Memorial Trust being named in the will are definitely ascertained as beneficiaries at the date of the testator's death;

3. That these institutions are charitable institutions, and that therefore the said 33% of 40% of the income was exempt under section 4(e) of the Income War Tax Act.

The Court held that the Burns Memorial Trust will never receive the portion of the accumulated income at issue as income but as corpus, and that such income was capitalized in accordance with the terms of the will. The five charitable institutions named as beneficiaries of the Trust will merely receive at some time in the future income

earned on the capitalized income. Neither the Royal Trust Company nor the Burns Memorial Trust administered by it are charitable institutions.

Accordingly, the appeal was dismissed.

RESIDENCE IN CANADA

Percy Walker Thomson, *Appellant*
and

The Minister of National Revenue, *Respondent*
The Supreme Court of Canada. January 24, 1946.

The appellant moved from Canada in 1923, for which year he paid income tax in Canada, and from then until 1932 he visited Canada on several occasions. In 1932 he established a summer residence in Canada, at which he spent some time, but less than 183 days, each year. The remainder of his time was spent chiefly in the United States, where he paid tax as a non-resident from 1930 to 1940, and thereafter as a resident. The Department of National Revenue assessed him for 1940 income tax, which assessment was affirmed by the Minister who held that he was residing or ordinarily resident in Canada during the year 1940. An appeal to the Exchequer Court of Canada was dismissed (Thorson, J., March 10, 1945. See *THE CANADIAN CHARTERED ACCOUNTANT*, May, 1945). This appeal was then brought to the Supreme Court of Canada.

The Court dismissed the appeal, holding that in 1940 the appellant was ordinarily resident in Canada under section 9(a). Even though he lived in Canada less than 183 days, his residence in Canada was in the ordinary and habitual course of his life, and was not temporary residence or residence for a temporary purpose.

Taschereau, J., dissenting, held that the appellant "should have been classified as a resident of the United States making occasional visits to Canada" and that the appeal should be allowed.

MEANING OF "CANADIAN DEBTOR"

His Majesty the King on the Information
of the Attorney General of Canada, *Appellant*
and

British Columbia Electric Railway Company, Limited, *Respondent*
The Supreme Court of Canada. February 11, 1946.

The respondent company was incorporated in England where it had its registered office and kept its principal register of members in respect of its 5% cumulative perpetual preference stock. In addition it kept a dominion register at Vancouver, B.C. It operated in British Columbia as an extra-provincial company. During the period between April 1, 1933, and April 29, 1941, the company declared and paid dividends to non-residents of Canada on this stock. The appellant claimed that the respondent company should have withheld 5% of such dividends and remitted the same to the Receiver General of Canada in an action before the Exchequer Court of Canada (Thorson, J., May 25, 1945. See THE CANADIAN CHARTERED ACCOUNTANT, July, 1945). The Exchequer Court held that the respondent is not a "Canadian debtor" within the meaning of section 9B(2) (a) of the Income War Tax Act, notwithstanding its residence in Canada; it is only upon such a debtor that the duty of tax collection and remission is imposed by section 9B(4); and no such duty having been placed upon the defendant, it cannot be liable under section 84 for failure to perform it. The Crown then brought this appeal to the Supreme Court of Canada.

The Supreme Court allowed the appeal.

Kerwin, J. (concurred in by the Chief Justice and Taschereau, J.) held that the expression "Canadian debtors" as used in section 9B(2) (a) means "companies resident in Canada" and that "The company was under a duty to obey the injunction in subsection 4 and since it did not do so it is liable to the penalty prescribed by section 84." Rand, J. (concurred in by Kellock, J.) held that the expression "Canadian debtor" means "a debtor resident in Canada by whom the act of paying the dividend as such is, under the obligation itself, to be initiated in and the payment to proceed from this country".

DOUBLE DEPRECIATION

The discretionary power of the Minister of National Revenue, to allow depreciation at not more than double the normal rates, has been extended to March 31, 1948. Housing and other priorities are indicated as special reasons for this extension. It is authorized by order in council P.C. 1449 dated April 16, 1946, reading as follows:

Whereas under the Income War Tax Act, the Minister of National Revenue in his discretion may allow depreciation at not more than double the rates normally allowed in respect of plant or equipment built or acquired in a period to be fixed by the Governor in Council if the taxpayer is, in the opinion of the minister, making a new investment by building or acquiring the plant or equipment;

And whereas the said period was fixed by order in council P.C. 8640 of November 10, 1944, as being that commencing on November tenth, nineteen hundred and forty-four, and ending on the last day of the year, nineteen hundred and forty-six or on the day two years from the day on which organized hostilities between Canada and Germany ceased wholly or substantially, whichever is the earlier;

And whereas having regard to the existing policy of giving priority to housing and in view of the short supply of various types of equipment and building materials, it is desirable that the period during which such plant or equipment is to be built or acquired should be extended to the thirty-first day of March, nineteen hundred and forty-eight;

And whereas it is desirable that industries planning postwar expansion, conversion or modernization, although such projects will not be proceeded with immediately, should prepare their plans with despatch, and to accomplish such purpose it is advisable to provide that applications for certification by the Minister of Reconstruction and Supply as provided for by section 3 of the said order in council must be filed with the Department of Reconstruction and Supply on or before the thirty-first day of March, nineteen hundred and forty-seven;

Therefore His Excellency the Governor General in Council, on the recommendation of the Minister of Finance, the Minister of Reconstruction and Supply and the Minister of National Revenue, and under and by virtue of sub-paragraph (ii) of paragraph (n) of subsection one of section six of the Income War Tax Act and The National Emergency Transitional Powers Act, 1945, is pleased to amend the said order in council P.C. 8640 and it is hereby further amended as follows:

1. Section 1 is revoked and the following substituted therefor:

1. The period commencing on November tenth, nineteen hundred and forty-four and ending on March thirty-first, nineteen hundred and forty-eight, is hereby fixed as the period mentioned in sub-paragraph (ii) of paragraph (n) of subsection one of section six of the Income War Tax Act.

2. Section 2 is amended by adding thereto the following subsection:

(4) The application for the certification by the Minister of Reconstruction and Supply as provided for by subsection (3) of this section 2 must be filed with the Department of Reconstruction and Supply on or before the thirty-first day of March, nineteen hundred and forty-seven.

Personals

Clarkson, Gordon, Dilworth & Nash, chartered accountants, announce that hereafter they will carry on the practice of their profession under the name of Clarkson, Gordon & Co., with offices in Toronto, Montreal, Hamilton, Winnipeg and Vancouver.

Patriquin, Johnstone and Company announce a change in the firm name to Patriquin, Duncan, McClary, McClary and King, chartered accountants, Tegler Building, Edmonton, Alberta. Mr. Edward King, B.Com., C.A., the new member, has been associated with the firm for a considerable period. Mr. W. Stuart Johnstone, F.C.A., is withdrawing from public practice and is moving to Vancouver, B.C.

Robert B. Moran, C.A., announces the commencement of professional practice with office at 14 Toronto Street, Toronto.

E. A. Campbell & Company, chartered accountants, Kelowna, British Columbia, announce the removal of their office to 102 Radio Building, and the change of the firm name to Campbell, Imrie & Shankland.

W. Wood, C.A., who has recently been demobilized after six years' service with the Army, announces the opening of an office in the General Trust Building, Barrington Street, Halifax, Nova Scotia, for the practice of his profession.

J. Ray Lewis, C.A., recently with the Income Tax Division, Ottawa District Office, announces that he has opened an office for the practice of his profession at 48 Sparks Street, Ottawa.

John A. Partridge, C.A., announces the opening of an office for the practice of his profession at 129 Princess Street, Kingston, Ontario.

STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

NOTES AND COMMENT

More than one request has been received that the "Problems and Solutions" should not be restricted to the accounting papers but should include representative questions from the auditing papers. Considerations of space have dictated this limitation but an attempt will be made during this year to find room for at least a few auditing questions.

* * * *

We hope we may be excused for referring to a book published so long ago as 1939 but one of which we have previously made no mention. It is "Truth in Accounting" (Oxford University Press, \$4.75) whose author, Kenneth MacNeal, C.P.A., surely must qualify as the Jeremiah of our profession. Viewing the future he says: "I believe it can safely be said that public respect for the accounting profession is now less high than it was a decade ago . . . The tendency of the accounting profession to ignore the need for changing its methods does nothing to redeem its prestige". His criticism is centred on what he alleges to be the tendency to assume that although balance sheets fail to reflect current facts, profit and loss accounts can be made to do so. "This assumption is entirely untenable and indicates the next strategic retreat that accounting leadership will be forced to make if it continues in its present course. Balance sheets and profit and loss statements are interdependent. The latter cannot be complete and truthful unless the former are . . . Accountants should learn to be valuers or should employ valuers."

Whether he agrees with the main thesis of the book or not (and we for one are unable to do so) the contemplative reader will find in it a great deal of food for serious thought. There can be much genuine difference of opinion about the appropriate remedy even when there is unanimity in the diagnosis of the malady.

PUZZLE

There are twelve balls of the same size and appearance, eleven of which also weigh the same, the remaining one

being either heavier or lighter. In three weighings, on dual balancing scales, discover which ball is different and whether it is heavier or lighter than the others.

(This puzzle was contributed by "The Students", Ronald Griggs and Co., Winnipeg, and has been gratefully acknowledged. Further contributions by readers would be most welcome.)

SOLUTION TO LAST MONTH'S PUZZLE

The distance is 40 feet. The method of calculation is not easily demonstrated without a diagram but it can be supposed that a sheet of cardboard is cut so that if folded properly, it would make a model of the room. The one smaller side wall is cut out so that it is attached to one end of the rectangle representing the floor, the other side wall attached to the other end of the rectangle representing the ceiling. The cardboard is spread out flat, the positions occupied by the fly and the spider are marked and these points are joined by a straight line lying wholly on the cardboard. This line represents the shortest route between the fly and the spider. Its length can be computed, by the principle of the square on the hypotenuse, as the square root of $(32)^2 \div (24)^2 = 40$.

PROBLEMS AND SOLUTIONS

THE PROVINCIAL INSTITUTES OF CHARTERED ACCOUNTANTS

Solutions presented in this section are prepared by practising members of the several provincial Institutes and represent the personal views and opinions of those members. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM I

INTERMEDIATE EXAMINATION, DECEMBER 1945

Accounting I, Question 2 (15 marks)

A company manufacturing clothing divides its business into the following departments:

1. Children's clothes
2. Men's work clothes
3. Men's shirts
4. Ladies' dresses

All materials and direct labour costs are charged directly to the department concerned, but a method of distributing indirect factory expenses, selling and general administrative expenses is required.

STUDENTS' DEPARTMENT

The following expenses were incurred during the past year:

Rent	\$ 3,000
Insurance on stock	600
Salesmen's salaries	10,000
Office salaries	22,000
Stationery	1,500
Insurance on buildings	450
Heating	500
Interest on bank loan	800
Lighting	300
Telephone	200
Cleaning	250
Other general and administrative expenses	1,000
Commissions	5,000

You are given the following information:

Floor space occupied by each department

1.	1000 sq. ft.
2.	1300 sq. ft.
3.	1200 sq. ft.
4.	2000 sq. ft.

Sales of each department

1.	\$ 50,000
2.	70,000
3.	100,000
4.	80,000

Average inventories

1.	\$ 15,000
2.	25,000
3.	30,000
4.	10,000

Required:

Divide the expenses for the year in a manner you would consider to be equitable.

A SOLUTION

A Manufacturing Company

Expense Distribution for the Year Ending —

Item	Total	Departments			
		1	2	3	4
<i>Distributed on basis of floor space occupied</i>					
Rent	\$ 3,000	\$ 546	\$ 709	\$ 654	\$ 1,091
Insurance on buildings ..	450	82	106	98	164
Heating	500	91	118	109	182
Lighting	300	55	71	65	109
Cleaning	250	45	59	55	91
<i>Distributed on basis of sales</i>					
Salesmens' Salaries	10,000	1,667	2,333	3,333	2,667
Office Salaries	22,000	3,667	5,133	7,333	5,867
Stationery	1,500	250	350	500	400
Telephone	200	33	47	67	53
General & administrative .	1,000	167	233	333	267
Commissions	5,000	833	1,167	1,667	1,333

THE CANADIAN CHARTERED ACCOUNTANT

*Distributed on basis of
average inventories*

Insurance on stock	600	112	188	225	75
Interest on bank loans ...	800	150	250	300	100
	<u>\$45,600</u>	<u>\$ 7,698</u>	<u>\$10,764</u>	<u>\$14,739</u>	<u>\$12,399</u>

PROBLEM II

FINAL EXAMINATION, DECEMBER 1945

Accounting I, Question 2 (20 marks)

The directors of one of your client companies are puzzled by the changes in the company's working capital, which they expected to find greatly increased as a result of large profits and new financing. They have asked the comptroller to prepare a memorandum for their next meeting explaining the changes. The comptroller in turn has asked you to prepare some of the data for his memorandum and gives you the following information:

Trial Balance		30th June	
Debits		1945	1944
Cash on hand and in bank	\$	50,200	\$ 70,450
Dominion of Canada bonds		350,000	
Accounts receivable		381,125	231,025
Inventories		775,685	560,900
Investment in and advances to associated company		200,000	50,000
Prepaid expenses		9,500	7,025
Post-war refund under Excess Profits Tax Act ..		77,000	35,000
Fixed assets at cost		785,730	553,500
		<u>\$2,629,240</u>	<u>\$1,507,900</u>
Credits			
Bank loan	\$	350,000	
Accounts payable and accrued charges		240,100	\$ 174,250
Provision for renegotiation refund		50,000	
Reserve for taxes on income		175,000	75,000
Reserve for decline in inventory value		53,000	38,000
Reserve for depreciation		312,290	270,300
Bonds payable		500,000	200,000
Capital stock		200,000	200,000
Earned surplus		748,850	550,350
		<u>\$2,629,240</u>	<u>\$1,507,900</u>

Net profit for the year after all charges was \$368,500 including the increase in the refundable portion of excess profits taxes. Provision for refund to the Department of Munitions and Supply was made in respect of the sales of prior years, and was charged directly to the surplus account. To finance additions to fixed assets a bond issue was sold on 1st March 1945 and the previously outstanding bond issue was called for redemption; expenses in connection therewith, \$20,000, were charged to surplus account. The only entry affecting the depreciation reserve, other than the annual provision, was the reversal of \$5,010 depreciation in respect of assets disposed of (original cost \$11,020). A dividend of \$100,000 was paid on 15th November 1944.

STUDENTS' DEPARTMENT

Required:

Prepare a statement illustrating the changes in the current and prepaid assets, and current liabilities, and a statement showing the source and application of funds during the year.

A SOLUTION COMPARATIVE STATEMENT OF CURRENT AND PREPAID ASSETS AND CURRENT LIABILITIES

	Year Ended 30th June 1945	Year Ended 30th June or 1944	Increase Decrease (—)
Current and prepaid assets:			
Cash on hand and in bank	\$ 50,200	\$ 70,450	\$ 20,250—
Dominion of Canada bonds	350,000		350,000
Accounts receivable	381,125	231,025	150,100
Inventories, less reserve	722,685	522,900	199,785
Prepaid expenses	9,500	7,025	2,475
	<u>\$1,513,510</u>	<u>\$ 831,400</u>	<u>\$ 682,110</u>
Current liabilities:			
Bank loan	\$ 350,000		\$ 350,000
Accounts payable and accrued charges	240,100	\$ 174,250	65,850
Provision for renegotiation refund	50,000		50,000
Reserve for taxes on income	175,000	75,000	100,000
	<u>\$ 815,100</u>	<u>\$ 249,250</u>	<u>\$ 565,850</u>
Net working capital	<u>\$ 698,410</u>	<u>\$ 582,150</u>	<u>\$ 116,260</u>

STATEMENT OF THE SOURCE AND APPLICATION OF FUNDS

Funds provided from current operations—		
Consisting of the net profit for the year after all charges	\$ 368,500	
Together with the provision for depreciation which did not in itself involve an outlay of funds	47,000	
	<u>\$ 415,500</u>	
Less the post-war refundable portion of taxes included in the current year's profit	42,000	\$ 373,500
Funds provided from other sources—		
Proceeds of bonds sold 1st March 1945	\$ 500,000	
Less bonds redeemed as of that date	200,000	
	<u>\$300,000</u>	
Less cost of issue and redemption	20,000	280,000
Total funds provided		<u>\$ 653,500</u>
Funds were paid out or set aside for the following—		
Dividend on common shares paid 15th November 1944	\$ 100,000	
Advances to associated company..	150,000	
Renegotiation refund to Depart- ment of Munitions and Supply.	50,000	
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Purchase of fixed assets	\$ 243,250		
Less proceeds of assets disposed of	6,010	237,240	537,240
Increase in working capital			<u>\$ 116,260</u>

PROBLEM III

FINAL EXAMINATION, DECEMBER 1945

Accounting I, Question 3 (30 marks)

The Engineering Company Limited, manufacturers of steel products of various types, has devoted part of its capacity since early in 1942 to the manufacture of war supplies. The directors are concerned about the large profits being earned on the war business and feel that a voluntary refund should be made to the Department of Munitions and Supply. The directors engage you to help them compute a reasonable refund and present to you the following comparative statement for the years 1942, 1943 and 1944.

	1942	1943	1944
Sales	\$1,000,000	\$1,500,000	\$2,500,000
Less:			
Materials, labour and operating expenses	\$ 650,000	\$ 900,000	\$1,350,000
Depreciation	100,000	160,000	230,000
Selling and advertising expense	50,000	60,000	100,000
Administrative expense	100,000	120,000	150,000
	<u>\$ 900,000</u>	<u>\$1,240,000</u>	<u>\$1,830,000</u>
Net profit	<u>\$ 100,000</u>	<u>\$ 260,000</u>	<u>\$ 670,000</u>
Standard profit	<u>\$ 120,000</u>	<u>\$ 120,000</u>	<u>\$ 120,000</u>

It is decided that the voluntary refund should be computed in approximately the same manner as might be adopted by the investigators of the Department of Munitions and Supply, and the following principles should, therefore, govern your calculations:

(a) A reasonable profit on the war business in this particular case would be 10% of cost.

(b) All items of expense which would not be admitted under the D.M.S. costing memorandum will be excluded from the cost of the war business.

(c) "Special depreciation" will be admitted as part of cost, but no profit will be allowed on such depreciation.

(d) Costs of production, administration, etc., may be allocated to war business in the same ratio that the annual amount of sales considered to be war business bears to total sales (except that the total of "special depreciation" may be considered as applicable to the war business).

(e) The Department of Munitions and Supply will agree to apply to the Department of National Revenue for that portion of the refund represented by the reduction in income and excess profits taxes that will be occasioned by the refund. (Assume that in all years involved the effective rates of tax are 40% up to $\frac{1}{4}$ of standard profit and 100% on profits in excess of $\frac{1}{4}$ of standard profit, with 20% of the latter taxes refundable after the war.)

Your investigation reveals the following information:

STUDENTS' DEPARTMENT

1. The war business in 1942, 1943 and 1944 amounted to 20%, 40% and 60% respectively of total sales.

2. All the items of cost appear to be admissible under the D.M.S. costing memorandum except selling and advertising expense, none of which should be claimed.

3. Additions to fixed assets on which special depreciation was claimed were \$30,000, \$100,000 and \$100,000 respectively in 1942, 1943 and 1944. The 1942 additions were given a three-year life, and the 1943 and 1944 additions a two-year life, for the purpose of the special depreciation.

Required:

Based on the foregoing.

1. Prepare a statement showing what voluntary refund of profits would be reasonable.

2. Draft the paragraph of your letter to the directors explaining what the actual cash refund to the Department of Munitions and Supply would have to be, the amount that would represent a reduction in taxes to be transferred by the Department of National Revenue, and the amount by which the post-war tax refund would be reduced.

A SOLUTION

THE ENGINEERING COMPANY LIMITED

Part 1

CALCULATION OF VOLUNTARY REFUNDS TO THE DEPARTMENT OF MUNITIONS AND SUPPLY

	1942	1943	1944
Total sales	\$1,000,000	\$1,500,000	\$2,500,000
Percentage of sales considered to be war business	20%	40%	60%
Total cost of sales	\$ 900,000	\$1,240,000	\$1,830,000
Deduct expenses not allowed as part of cost of the war business	50,000	60,000	100,000
	\$ 850,000	\$1,180,000	\$1,730,000
Deduct special depreciation, all applicable to war business, but on which no profit will be allowed ..	10,000	60,000	110,000
Adjusted costs, to be allocated pro rata to war business	\$ 840,000	\$1,120,000	\$1,620,000
Cost applicable to war business ...	\$ 168,000	\$ 448,000	\$ 972,000
Add 10% profit margin	16,800	44,800	97,200
Add special depreciation admitted as part of final cost	10,000	60,000	110,000
Proposed adjusted billing value of war business	\$ 194,800	\$ 552,800	\$1,179,200
Actual billing value of war business	200,000	600,000	1,500,000
Proposed voluntary renegotiation refund	\$ 5,200	\$ 47,200	\$ 320,800

Part 2

The refund of \$373,200 proposed, as outlined above, will actually involve a very small cash outlay so far as your company is concerned. In the year 1942 your profits were subject to tax at the minimum

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rate of 40%, which means that 40% of \$5,200 (the 1942 refund) will be refunded by the Department of National Revenue, and 60%, or \$3,120, will be payable by the company. In 1943 and 1944 your profits were subject to the 100% maximum rate, and the full amount of the refunds in respect of those years will therefore come from the Department of National Revenue, and no cash will be involved so far as the company is concerned. The company must, however, give up a part of the refundable portion of the taxes already paid. The amount lost will be 20% of the 1943 and 1944 renegotiation refunds, or \$9,440 and \$64,160 respectively. The renegotiation refunds and tax adjustments may therefore be summarized as follows:

	1942	1943	1944	Total
Proposed renegotiation refund	\$ 5,200	\$ 47,200	\$320,800	\$373,200
Amount that will be represented by a reduction in taxes, and will be transferred by the Department of National Revenue	2,080	47,200	320,800	370,080
Amount payable by the company	\$ 3,120	0	0	\$ 3,120
Reduction in the refundable portion of taxes, receivable after the war	0	\$ 9,440	\$ 64,160	\$ 73,600

Obituaries

The Late Elmer Ross Epps

The Society of Chartered Accountants of the Province of Quebec regrets to announce the death of Elmer Ross Epps at Toronto in his 51st year.

The late Mr. Epps was admitted a member of the Society on December 20th, 1926, after serving his apprenticeship with Walter W. Rathie & Company. He subsequently moved to Toronto, and at the time of his death was employed in the Corporation Department of the Department of National Revenue in Toronto.

To his bereaved family the Society offers sincere sympathy.